Mary Cottrell, Secretary
Department of Telecommunications and Energy
One South Station, 2nd Floor
Boston, MA 02110

December 18, 2004

RE: Cambridge Electric Light Company, Commonwealth Electric Company, Boston Edison Company, NSTAR Gas Company, d/b/a NSTAR, D.T.E 03 – 47-B (Phase II)

Dear Secretary Cottrell:

On October 31, 2003, the Department of Telecommunications and Energy ("Department") issued an order approving a new reconciling tariff formula to recover costs related to pensions and post-retirement benefits other than pensions ("PBOPs") for NSTAR in D.T.E. 03-47-B. On December 1, 2003, the Company submitted a compliance filing. On October 5, 2004, the Department issued an order of notice requesting comments on the compliance filing and, after allowing a limited period for discovery, conducted a hearing on December 9, 2004. The Attorney General submits this letter to the Department as his comments.

As the proponent of a change in rates, NSTAR has the burden for demonstrating that 1) that it has complied with the Department's order in DTE 03-47-B and 03-47-C, and 2) the resulting rates are just and reasonable. The Department should reject this filing because the Company has not submitted sufficient evidence to demonstrate NSTAR has objectively applied the tariff approved by the Department or that the overall rates resulting from the tariff adjustment are just and reasonable. G. L. c. 164, §94 (Department must determine "propriety" of general rate increase after hearing). In the alternative, if the Department does approve the filing subject to ongoing reconciliations, it should make the adjustments recommended in these comments. In addition, the Department should also continue its practice of allowing discovery, hearings and briefs to investigate each annual compliance filing, including the filing noticed on December 9, 2004, and docketed as D.T.E. 04-118.

As the Attorney General noted throughout the procedural history of this investigation, NSTAR has not provided a fixed formula with objective elements, but rather seeks approval of the application of a formula with complicated variables that contain a considerable degree of subjectivity in their calculation. *See* M.D.T.E. Nos. 109, 209, 309 and 409. Transcript, December 9, 2004, Hearing ("Trans."), pp. 29-30 (outside consultant's computer model provides actuarial calculations), pp. 30-52 (collaborative process between Company and auditors to select discount rate), pp. 53- 60 (variable asset mix used to determine return for pension calculations), pp. 60-61 (rate increase of employee compensation includes assumptions for inflation,

productivity and individual merit factors), pp. 63-64 (healthcare cost trends for PBOPs determined by management and actuaries). Small percentage changes in some of these variables results in very large dollar changes in the amount of pension expense recovered from consumers during any given year.

As amply demonstrated by the record evidence in this case, the NSTAR pension formula contains inputs that involve subjective decisions and actuarial judgement. It is not the type of objective, actual cost "'pass-through' provision operating in terms of a mathematical formula" approved by the Supreme Judicial Court. *Consumers Organization For Fair Energy Equity, Inc. v. D.P.U.*, 368 Mass. 599, 602 (1975). Unlike the Cost of Gas Adjustment Clause ("CGAC"), which passes through actual costs, the Company can produce no bills or invoices for these pension and PBOP costs. While the NSTAR formula appears to be fixed by the Department's initial decision, it contains far too many complicated moving elements to be considered fixed from one reconciliation filing to the next.

The complexity of the elements of the formula and the subjectivity of the accounting treatment of the inputs involved can lead to material errors. For example, the Company proposed to include in its Pension Adjustment Factor ("PAF") $9.937 million in carrying charges on its prepaid pension balance for the twelve months of 2003, including the eight-month period during the rate freeze it had promised customers during its merger case in D.T.E. 99-19. Exh. NSTAR-1, PAF Filing, page 1, line 19. The Department in its initial Order denied the Company's proposed recovery of pension and PBOPs costs associated with the rate freeze period. D.T.E. 03-47-B (Phase I), p. 33. Those costs include not only the pension and PBOPs expenses themselves, but also the return on any prepaid balance. Therefore, the Department should deny the recovery of the carrying charges on the prepaid balance during the rate freeze and reduce the PAF reconciliation by two-thirds or $6.625 million [$6.625 million = $9.937 million x 2 / 3]. In addition, the Company failed to credit customers $10.3 million related to carrying charges on prepaid pension obligations recovered through transmission, an error uncovered during discovery on the compliance filing and only after the Attorney General filed a motion to compel additional answers to discovery on November 17, 2004. Trans., pp. 18-19 and Exh. AG 1-4 (supplemental).

The Company also failed to correct its 2003 PBOPs Expense for the reduction in cost associated with the Medicare Prescription Drug Improvement and Modernization Act of 2003. The Department allows adjustments to expenses when they are known and measurable. The $7 million annual change in the Company's PBOPs cost for 2003 was known and measurable and should be made to the reconciliation adjustment mechanism for that year. Exh. AG-1-29, Form 10-Q for period June 30, 2004, "Other Postretirement Benefits." Furthermore, Financial Standards Accounting Board's Statement Number 106, *Employer's Accounting for Postretirement Benefits Other Than Pensions*, Paragraph 40 states:

> Presently enacted changes in the law or amendments of the plans of other health care providers that take effect in future periods and that will affect the future level of their benefit coverage ***shall be considered in current-period measurements*** for

benefits expected to be provided in those future periods. (emphasis added).

The Company's witness, Mr. Farrell, testified that the FASB Staff Position 106-1 allows later recognition of the change in cost. *See* Trans., p. 67 and Exh. AG-1-29, Form 10-Q for period June 30, 2004, "Other Postretirement Benefits." This fact does not mean, however, that the Company cannot provide for immediate recognition of the change in 2003. Indeed, since NSTAR customers are now directly funding this cost, they should receive the immediate benefit of this known and measurable change in cost by reducing the 2003 PBOP amount used to calculate the reconciliation adjustment by $1.75 million.[1]

The immediate recognition of these types of changes in pension and PBOPs costs is necessary to be fair to customers and to maximize their savings as a result of the change in the law. According to the Company, timely recognition of the reduction in customer payments due to this change in cost, like a change in the assumptions used to determine pension and PBOPs costs, is meaningless, since they will all "come-out-in-the-wash" in some future reconciliation. Trans., p. 72. This position is inappropriate for three reasons: (1) the change in the law is not a simple, minor change in assumption that will vary up and down with the other assumptions in the future, but rather a one-time complete restructuring of the benefit cost to the Company; (2) it fails to recognize that the discount rate for most customers is higher than that of the Company, and therefore, customers will lose the time value of money associated with this change; and (3) without immediate recognition of the lower expense, the Company is allowed to keep customer monies unnecessarily for over 12 years -- the period over which the Company has to recognize the change. Exhibit RR-AG-1. Therefore, the Department should order the Company to recognize the $1.75 million change in the 2003 PBOP expense, after the rate freeze, associated with the Medicare Prescription Drug Improvement and Modernization Act of 2003.

In permitting an increase in rates under the pension adjustment mechanism, the Department may not ignore the constitutional and statutory limits or the numerous court decisions requiring that rates be neither confiscatory nor exorbitant regardless of the ratemaking methods employed during the proceedings. *See Permian Basin Area Rate Cases*, 390 U.S. 747, 769 (1968) ("investor interests provide only one of the variables in the constitutional calculus of reasonableness"). The Department must carefully balance the "investor and consumer interests in permitting a reasonable return on the utility's investment." *New England Telephone & Telegraph v. Department of Public Utilities*, 360 Mass. 443, 472 (1971)("[T]he fixing of 'just and reasonable' rates, involves a balancing of the investor and the consumer interests"); *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 602-603 (1944)("Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling"); *Bluefield WW & Improvement Co. v. Public Service Commission*, 262 U.S. 679, 692-93 (1923) (a company has no right "to profits such as are realized or anticipated in highly

[1] This should reduce the reconciliation adjustment request by the annual change in cost multiplied by the 75 percent charged to expense multiplied by one third to recognize the portion during 2003 after the rate freeze [$1.75 million = annual change in $7 million x 0.75 x 1/3].

profitable enterprises or speculative ventures.")

The Department should review, at a minimum, a company's earnings before ordering a general rate increase, in order to determine whether that increase is needed to ensure reasonable compensation. In this proceeding, the Company has not provided sufficient evidence to demonstrate the propriety of its rates. NSTAR has also not provided any evidence that the increased amounts of pension related expenses recovered from customers, an amount above the level already included in rates, results in just and reasonable rates. The Department should not permit additional pension recoveries under these circumstances.

For these reasons, the Department should adopt the Attorney General's recommendations to assure that NSTAR's treatment of its pension related costs is in the best interests of consumers.

Respectfully submitted,

Alexander J. Cochis
Assistant Attorney General

cc: Service list